



Engineering Services
City of Frisco, Texas

Memorandum

To: Honorable Mayor Maso and Members of the Frisco City Council

cc: George Purefoy, City Manager
Ron Patterson, Assistant City Manager

From: Ben Brezina, Contract Administrator/Assistant to the City Manager

Date: April 20, 2010

Subject: Consider and act upon adoption of a resolution endorsing the Cities Aggregation Power Project (CAPP) 2010 Sunset Legislative Advocacy.

Action Requested: City Council consideration and adoption of a resolution endorsing the Cities Aggregation Power Project 2010 Sunset Legislative Advocacy.

Background Information: The City of Frisco is a member of Cities Aggregation Power Project, Inc. ("CAPP"). The CAPP Board of Directors has voted to authorize certain legislative efforts pertaining to the Sunset Commission's review of the Public Utility Commission ("PUC") and the Electric Reliability Council of Texas ("ERCOT"). The Sunset agency's recommendations pertaining to both organizations are expected to form the basis of bills during the 82nd Legislative Session in 2011. As such, CAPP will recommend legislative action related to the Sunset Commission's examination of both the PUC and ERCOT. In addition, CAPP will offer all resolutions of its members during Sunset hearings to apprise lawmakers of CAPP Cities' perspective on how to make the electric market more competitive and beneficial to consumers. The following background information has been provided by CAPP:

In 1999, Texas lawmakers adopted Senate Bill 7, the state's electric deregulation law. The legislation expanded competition in the wholesale electricity market and opened the door to competition among electric retailers. Proponents of the legislation promised lower electric prices.

Unfortunately, the reality has been otherwise. Although Texans paid electric prices well below the national average during the decade before Senate Bill 7 was passed, customers in deregulated parts of the state now pay prices above the national average. In fact, even the lowest residential electric rates in deregulated areas of Texas typically exceed rates paid by **all residents** of neighboring states, such as those in Oklahoma and Louisiana.

CAPP believes that for deregulation to fulfill its promise, the market must become more competitive. Problems include the ability of some generators to exercise monopoly-like control in large swaths of the state, and the inability of many consumers to make informed choices because of confusion in the retail electricity market. Efforts to address market design issues by ERCOT also have been mismanaged, gone over budget and fallen behind schedule.

As an active market participant, CAPP is in the unique position to identify problems that have developed in the deregulated marketplace and to provide a consumer's perspective to legislators interested in fixing those problems.

Based upon this point of view, CAPP has formulated recommendations for the Sunset Advisory Commission as it conducts its PUC and ERCOT reviews. CAPP's recommendations are intended to improve competition in the electric market place by making the PUC and ERCOT more accountable to consumers, by limiting market power, and by creating competitive options for all customers. CAPP's recommendations reflect the organization's desire for a truly healthy electric market where consumers can save and competition can flourish. Such a market — one where power remains affordable and reliable — will mean more economic development for Texas cities and a better standard of living for our citizens

Legislative change is necessary to better protect cities' budgets, enhance cities' ability to protect their citizens, and increase competition among retail providers. The following changes are proposed by the CAPP Board:

- All generators, regardless of size, should explicitly be barred from the unlawful exercise of market power.

Current PUC rules protect relatively small generation companies from prosecution for anti-competitive behavior. But generators that control a small portion of the wholesale electricity market can sometimes have a big impact on prices. For instance, a relatively small operator in Texas temporarily drove up overall spot market prices in 2007 by engaging in an energy bidding practice that the Wall Street Journal said was "reminiscent of one that played a role in the meltdown of California's electricity market."

- Entities such as municipalities, commercial customers or retail electric providers harmed by wholesale market abuse should be given explicit standing to participate in market power abuse enforcement actions brought by the PUC.

In 2007, the Texas Public Utility Commission initiated an enforcement proceeding against TXU for allegedly engaging in anti-competitive behavior. PUC staff found that improper actions by TXU during a short interval in 2005 had increased overall wholesale energy costs by more than \$50 million. However, Retail Electric Providers, municipalities and others harmed by these higher costs were barred from participating in the enforcement proceeding. Such entities can contribute resources and expertise to the often overburdened PUC.

- Fines should be increased for market abuses in such a way that the PUC can order full restitution to the market, market participants, or parties injured by the violation.

In the above case, TXU's improper behavior was found by the PUC staff to have caused more than \$50 million in harm to the wholesale energy market. However, the PUC fined the company only \$15 million — an amount not even equal to the extra revenue the PUC said TXU generated from its anti-competitive activities.

- Activities defined as market abuse by the Federal Energy Regulatory Commission should be prohibited.

According to a 2007 Wall Street Journal report, a generation company operating in Texas has freely engaged in an activity that appears to be very similar to energy bidding practices associated with Enron behavior in California. However, the activities are not expressly prohibited in Texas and as a consequence of the company's actions, it can collect \$157,000 an hour to run its plant — or more than 10 times the amount it would collect under more typical circumstances, according to the newspaper. The FERC, with authority over most wholesale electricity markets in the U.S., has the ability to recognize, define and prohibit market power abuse. Texas should prohibit the type of market abuse that occurs elsewhere in the country, as prescribed by the FERC.

- The statutory purpose of the PUC should be modified to ensure that the agency harmonizes its pursuit of competition with the protection of electric consumers.

Leaders at the Texas Public Utility Commission are some of state government's most enthusiastic advocates for electric competition. However, in their zeal to promote the Texas deregulation law, leaders at the PUC have overlooked the

higher electric prices paid by Texans relative to electric prices elsewhere. A slight adjustment of the Public Utility Regulatory Act would direct the agency to maintain its focus on consumer protection, even while it continues promoting electric competition.

- As a condition of conducting business in Texas, Retail Electric Providers (“REPs”) should be required to include among their offers one standard electricity package that has PUC-approved terms and conditions. Such standard offer products will ensure that REPs compete based on price, not on customer confusion.

Comparing electric deals can be difficult. A quick review of the power to choose website reveals a bewildering array of offers, each with difficult-to-comprehend fine print. Because the details of each offer vary, it is nearly impossible for consumers to make apples-to-apples comparisons when they shop for electricity. Requiring REPs to include among their offers a standard deal established by the Public Utility Commission would reduce confusion among residential electricity consumers. REPs would have the freedom to price such standard deals in any way they see fit.

- The number of consumer representatives on the ERCOT board should be increased from the current three members, to six.

The ERCOT board sets many important rules for the Texas wholesale electricity market. The board is comprised of men and women who represent electric generation companies, retail electric providers and others with a financial stake in the market. However, end-use consumers — that is, those who ultimately pay all costs associated with the market — have been historically under-represented. As a consequence, consumers have been unable to block or mitigate potentially expensive initiatives that may benefit those with a financial interest in higher electric prices, but which do not hold any clear benefit for end-use consumers.

- The Office of the Comptroller should be assigned a seat on the ERCOT board and on appropriate budget oversight panels within ERCOT. The Comptroller’s office should be given access to all ERCOT contracting material and be charged with conducting a bi-annual performance review of ERCOT.

Mismanagement at ERCOT has led to cost overruns and even criminal convictions by top officials there. In 2003, for instance, the PUC directed ERCOT to begin making important changes to its management system for the wholesale electricity market. These changes were estimated to cost no more than \$76.3 million and were expected to be in place by Oct. 1, 2006. Unfortunately, the project’s costs have increased by at least 800 percent, and it is now four years behind schedule. Comptroller oversight would help discourage such costly missteps in the future.

- The PUC should be required to provide prior approval of all debt financing by ERCOT.

Debt service costs at ERCOT have increased by more than 400 percent since the 2003 fiscal year. The organization also has increased its use of debt to finance capital projects in recent years, including at least one recent capital project that is 100 percent financed with debt. More PUC oversight is required to ensure that the organization does not meet its annual budget targets through the inappropriate use of debt to shift costs into the future.

Alternatives: The City Council could consider the following alternatives:

- City Council consideration and adoption of a resolution endorsing CAPP's 2010 Sunset Legislative Advocacy
- Input towards the discussion as desired;
- Deny and send back to staff with direction.

Financial Considerations: None

Legal Review: Not Applicable

Supporting Documents: Supporting documents include the following items:

- Copy of resolution endorsing CAPP's 2010 Sunset Advocacy

Staff Recommendation: Staff recommends City Council adopts a resolution endorsing CAPP's 2010 Sunset Legislative Advocacy.